

No. 10,662

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

WELLS FARGO BANK & UNION TRUST Co.,  
Executor of the Estate of Ben F. Stern-  
heim, Deceased,

*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

Upon Petition to Review a Decision of the Tax Court  
of the United States.

PETITIONER'S OPENING BRIEF.

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as of date of death - 2 Cir. 117-2-97

92-79-2-107-  
widow's deduction

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yet in arriving at value of trust estate

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I.

**JURISDICTIONAL STATEMENT.**

By this proceeding petitioner, Wells Fargo Bank & Union Trust Co. as executor of the estate of Ben F. Sternheim, deceased, seeks the redetermination of a deficiency in federal estate taxes determined by respondent to be payable on account of the death of decedent.

Jurisdiction of the proceeding was conferred upon the Tax Court of the United States by Section 871 (e) of the Internal Revenue Code (26 U.S.C.A. Sec. 871

(e)). The provisions of Sections 1141 and 1142 of the Internal Revenue Code (26 U.S.C.A. Secs. 1141 and 1142) give jurisdiction to this Court.

The pleadings necessary to the existence of jurisdiction are the petition for redetermination of deficiency (T. 3) and the answer thereto (T. 20).

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## II.

### STATEMENT OF THE CASE AND QUESTION INVOLVED ON APPEAL.

#### (a) Statement of the case.

This petition for review is concerned with the taxability of gifts in remainder to charitable institutions where the trustee has a qualified power to expend corpus for the benefit of the income beneficiary.

Ben F. Sternheim (hereinafter called "the decedent") died on April 9, 1940, a resident of the City and County of San Francisco, State of California. (T. 13.) He left a will (T. 44), with the provisions of which this petition for review is not concerned, but which has been included in the record in order that the Court may have the complete background of the case.

Part of the estate of the decedent for the purposes of the federal estate tax consisted of property held by Wells Fargo Bank & Union Trust Co. as trustee of a revocable *inter vivos* trust created by the decedent on June 9, 1938. (T. 53, 54 and 55.) The value of the trust estate at the date of decedent's death was approximately \$96,000. (T. 55.) Blanche Sternheim,

sister of the decedent, was named as life beneficiary, the trust agreement having provided that her estate should vest in enjoyment upon the death of the decedent. (T. 61.) Upon the death of Blanche Sternheim the principal of the trust estate is to be distributed among three charitable institutions. (T. 61.)

The trust agreement conferred upon the trustee power in its uncontrolled discretion to withdraw and expend principal of the trust up to ten per cent (10%) per annum of the value thereof in the event of sickness, accident, want or other emergency to the income beneficiary. (T. 62.) The presence of this power prompted the respondent to disallow deduction of the value of the charitable gifts as claimed by petitioner and to determine that petitioner was liable for a deficiency. (T. 12-20.)

Because the evidence shows without contradiction that Blanche Sternheim is possessed of considerable independent means the contention was made at the trial, and is renewed here, that if there was any uncertainty in the value of the charitable remainders of the *inter vivos* trust, it was not "appreciably greater than the general uncertainty that attends human affairs" (*Ithaca Trust Co. v. United States*, 279 U. S. 151, 49 S. Ct. 291, 73 L. Ed. 647), with the result that the value of these remainders was deductible under the provisions of Section 812 (d) of the Internal Revenue Code (26 U.S.C.A. Section 812 (d)).

The evidence showed that after the death of Ben F. Sternheim the trustee of the *inter vivos* trust had

actually exercised the power to make payments of principal to the income beneficiary under peculiar circumstances hereinafter to be related. The Tax Court concluded that, *although in the absence of these payments a different result would have been compelled* (T. 27), the fact of this resort to principal rendered the value of the charitable remainders uncertain with consequent disallowance of the full deduction claimed by petitioner. (T. 27, 28.) But since the annual withdrawal of principal under the power conferred was limited to ten per cent of the value of the trust estate the Tax Court allowed a partial deduction to the extent of the value of the charitable gifts remaining after subtraction of the maximum possible withdrawals of principal during the life expectancy of the income beneficiary. (T. 28, 29.)

**(b) Question involved on appeal.**

The question involved is whether, as a matter of law, the fact of withdrawal and payment of principal as the result of events which transpired *after the death of decedent* may be employed as the basis for determining that *as of the date of the death of decedent* the value of the charitable remainders was uncertain.

This question was raised in the Tax Court by the introduction into evidence through stipulation of the parties of the fact and amount of the payments from principal (T. 88-92), and by the presentation of argument as to their legal effect.



### III. SPECIFICATION OF ERRORS.

1. The Tax Court erred in holding and deciding (T. 29) that the estate is not entitled to a deduction from the decedent's gross estate in the amount of the full value of the remainder interest in charitable institutions created by the revocable *inter vivos* trust agreement.

2. The Tax Court erred in holding and deciding (T. 28) that the withdrawal and payment of principal after the death of decedent by the trustee of the revocable *inter vivos* trust rendered the value of the charitable remainders so uncertain as not to be deductible under Section 812 (d) of the Internal Revenue Code.

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### IV. ARGUMENT.

#### (a) SUMMARY.

The uncontradicted evidence compels the conclusion that, measured by the circumstances prevailing at the date of decedent's death, the probability of invasion of the principal of the *inter vivos* trust was so remote as not to affect the value of the charitable remainders.

For the purpose of ascertaining the amount of federal estate tax the value of charitable remainders must be determined strictly as of the date of death. Fortuitous events occurring subsequent to the date of death cannot legally affect the determination of such value nor be employed as a basis for ascertaining whether or not the value of the remainder interests

is sufficiently certain to permit of its deduction in computing the tax.

In order to avoid confusion it should be stated that the argument will be concerned with two *inter vivos* trusts, the first being that created as aforesaid by the decedent for the benefit of Blanche Sternheim and certain charities, and the second being an irrevocable trust created for her own benefit by Blanche Sternheim. For convenience the first trust will be referred to as the "Ben Sternheim trust" and the second as the "Blanche Sternheim trust".

The provision authorizing withdrawal of principal will be called the "emergency clause".

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(b) RESUME OF THE CIRCUMSTANCES PREVAILING AT THE DATE OF DEATH OF THE DECEDENT.

Bearing upon the question of whether invasion of the corpus of the Ben Sternheim trust was or was not probable at the date of death, the following points, sustained by uncontradicted evidence found in the record, are pertinent:

1. Blanche Sternheim, the income beneficiary of the Ben Sternheim trust, entered into an irrevocable agreement of trust with respect to her own assets on July 25, 1929, the provisions of which were superseded by an amended trust agreement dated July 31, 1940. (T. 69-80.) Wells Fargo Bank & Union Trust Co. is now the trustee of this trust. (T. 68.)

2. The net income of this trust is payable to Miss Sternheim during her lifetime. (T. 74.)

*More power to invade corpus does not  
deduction 1257 2-401*

3. In the event that the net income of this trust should be less than \$600.00 per month, the trustee is directed to withdraw and pay from the principal such part thereof as may be necessary to make up the deficiency. (T. 75.)

4. The value of the assets of this trust is approximately \$138,000.00. (T. 82.)

5. The approximate annual net income of this trust is \$7300.00. (T. 82.)

6. In addition to the net income of this trust Miss Sternheim is entitled, upon her written request, to withdraw ten per cent of the corpus of the trust in any one calendar year. (T. 75.) The trust instrument also contains a provision similar to the emergency clause of the Ben Sternheim trust. (T. 75.)

7. The value of the assets of the Ben Sternheim trust was approximately \$96,000.00. (T. 55.)

8. The annual net income from the Ben Sternheim trust is approximately \$2400.00. (T. 66.)

9. Miss Sternheim is thus entitled to receive a combined annual net income from the two trusts of approximately \$9700.00.

10. Miss Sternheim is in the habit of saving from \$250.00 to \$300.00 per month from her income (T. 97), and is presently in a state of sound health. (T. 98.)

Upon evidence similar to that summarized above this Court has held that, despite the presence of power in the trustee to invade corpus, there was no such uncertainty in the value of charitable remainders as to deprive them of deductibility in computing the federal

estate tax. *Commissioner v. Bank of America National Trust & Savings Association*, 133 Fed. (2d) 753. Furthermore, the Tax Court in the case at bar actually found, and it is submitted properly so found, that these facts, exclusive of that regarding withdrawal of principal after decedent's death, would cause the possibility of invasion of the corpus of the Ben Sternheim trust at the date of death to be so remote as to be unworthy of consideration. (T. 27.)

In reaching the conclusion that the full value of the charitable remainders was not deductible, the Court, therefore, relied solely upon the evidence of these withdrawals. (T. 8.) The question of the legal propriety of resorting to such *expost facto* occurrences is thus squarely raised, for if the Court thereby committed error its own finding that in the absence of these occurrences the value of the charitable remainders was certain would compel modification of the judgment. Before considering the authorities it will be advisable to discuss briefly the circumstances which induced the invasion of the corpus of the trust.

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**(c) RESUME OF THE CIRCUMSTANCES SURROUNDING  
THE WITHDRAWAL OF PRINCIPAL.**

The withdrawals of principal after the death of the decedent fall into three categories. The first category grows out of the fact that prior to his death the decedent had acted as the trustee of the Blanche Sternheim trust. (T. 69, 70.) With the acquiescence of Miss Sternheim he had commingled the assets of the

trust with his individual property. (T. 88.) Upon his death the necessity for determining the share of the Blanche Sternheim trust in the unsegregated mass entailed some delay in the payment of income to Miss Sternheim. (T. 88, 89.) In order to compensate Miss Sternheim for this loss of income the trustee of the Ben Sternheim trust made three monthly payments of \$500.00 each to her pursuant to the emergency clause. (T. 89.) However, at the time of making the payments Miss Sternheim expressly agreed to repay the full amount which should ultimately be advanced. The evidence shows that she kept her promise. (T. 89, 90.)

Payments in the second category resulted from the fact that after the death of the decedent the federal government asserted a large income tax deficiency against his testamentary estate and against the assets of the Blanche Sternheim trust. (T. 85, 90.) The alleged liability was primarily that of Sternheim Company, a corporation, but was asserted against the estate and the trust as transferees of the corporate assets through dissolution. (T. 85.)

In the light of the magnitude of the income tax claim (in excess of \$500,000.00 (T. 90)), the trustee of the Blanche Sternheim trust felt compelled to withhold further payment of income to Miss Sternheim as a measure of protection against the possibility of ultimate recovery in full by the government accompanied by probable insufficiency of the combined assets of the trust and of the estate to satisfy the judgment in full. (T. 90, 91 and 92.)



Since no formal or informal claim for income taxes had been asserted against the Ben Sternheim trust (T. 92), a plan was devised by which \$500.00 per month was paid to Miss Sternheim from the principal of the last mentioned trust under the power conferred upon the trustee to expend principal in the event of emergency. (T. 92.) Thus, partial compensation was made to Miss Sternheim for her loss resulting from the retention of the income of her own trust. These payments, comprising a total of \$3700.00, continued until the income tax claims were finally settled. (T. 92.)

The third category of these principal payments involved an expenditure of approximately \$9000.00 towards settlement of the claims for income tax deficiencies, to which reference has been made. (T. 84, 87.) The Tax Court gained the impression that this payment was made in the exercise of the power to withdraw principal in case of emergency. (T. 28.) This impression was erroneous. In order to distribute the burden equitably among the various interests the payment was made in the exercise of the power to compromise (T. 87, 88) conferred by the provisions of the trust instrument (T. 59), after counsel for the trustee had become convinced that the government could and would look to the assets of the Ben Sternheim trust, if necessary, to satisfy its claims in the event of judgment for the full amount of the alleged deficiency. (T. 93.)

## (d) THE LEGAL EFFECT OF THE PAYMENTS OF PRINCIPAL

It is well settled that value, for the purpose of the federal estate tax, must be determined as of the date of death untainted by events thereafter transpiring.

In *United States v. Provident Trust Company*, 291 U. S. 272, 54 S. Ct. 389, 78 L. Ed. 793, the Court said:

“Article 53, Treasury Regulations 37, declares that the amount of the deduction in such case is the value at the date of decedent’s death of the remainder interest in the money or property which is devised or bequeathed to charity. It follows that in making a deduction for that interest, the value thereof must be determined from data available at the time of the death of decedent.”

In *Camp v. United States*, 44 Fed. (2d) 126, the Court said:

“In determining the value of the estate of a decedent for purposes of taxation, property owned by him is to be given the value which it had at the time of his death. The estate tax is a tax upon the passing of the estate of decedent, and in determining its amount the value of the estate must be taken at the time that it passes, i.e., at the time of death. Subsequent gains or losses through fluctuation in values or through fortunate or unfortunate trades cannot be considered.”

See, also,

*Meader v. United States* (Court of Claims), 26 F. Supp. 925.

The leading case on the subject is *Ithaca Trust Company v. United States*, 279 U. S. 151, 49 S. Ct. 291, 73 L. Ed. 647. There the testator created a trust for the benefit of his wife for life with authority to use from the principal any sum that might be necessary suitably to maintain her in as much comfort as she enjoyed at the date of the execution of the will. There were provisions for gifts over to charity to take effect upon the death of the testator's wife. The widow died shortly after the death of her husband and the contention was made by the taxpayer that this operated to increase the value of the charitable remainders. The Court held that it could not have this effect and said:

“The question is whether the amount of the diminution, that is, the length of the postponement, is to be determined by the event as it turned out, of the widow's death within six months, or by mortality tables showing the probabilities as they stood on the day when the testator died. The first impression is that it is absurd to resort to statistical probabilities when you know the fact. But this is due to inaccurate thinking. The estate so far as may be is settled as of the date of the testator's death. The tax is on the act of the testator, not on the receipt of property by the legatee. Therefore the value of the thing to be taxed must be estimated as of the time when the act is done. But the value of property at a given time depends upon the relative intensity of the social desire for it at that time, expressed in the money that it would bring in the market. Like all values, it depends largely on more or less certain prophecies of the future,



and the value is no less real at that time if later the prophecy turns out false than when it comes out true. Tempting as it is to correct uncertain probabilities by the now certain fact, we are of opinion that it cannot be done, but that the value of the wife's life interest must be estimated by the mortality tables."

If the untimely death of the life tenant in the *Ithaca* case could not, as a matter of law, be employed in retrospect as the foundation for determining the value of the charitable gifts at the date of the death, then by the same token the fact of actual resort to the emergency clause in the instant case cannot, as a matter of law, be seized upon as a basis for determining that the value of the charitable gifts was uncertain at the date of death.

The case of *Millard v. Humphrey*, 8 F. Supp. 784 (affirmed in 79 Fed. (2d) 104), is specifically in point. In that case the will provided that the wife of the testator should have the income from the trust estate during her lifetime and further bequeathed and devised to the wife any part of the principal of the residue of the estate which she might need for her support. The remainder interest went to charity. Deduction of the value of the charitable remainder was disallowed by the Commissioner on the ground that it could not be determined because of the right of the wife to invade the principal of the trust fund. It appeared that after the death of the testator an invasion of the principal actually occurred. The Court held that the income of the wife was more than sufficient to support her and that there was therefore no

reasonable possibility of invasion of the principal at the date of death. The deduction was therefore allowed. With respect to the question here in issue the Court said:

“The showing of the above facts, as of the date of the determination of the tax, brings this case within the scope of the cited cases in which the income could be determined as being sufficient to support and maintain the beneficiary. The fact that an invasion did actually occur to the extent of \$6,900. by consent of the remaindermen cannot affect the determination that at the time of decedent’s death the necessity of such an invasion was not foreseeable.”

The payments of principal from the Ben Sternheim trust as a result of the freezing of the income from the Blanche Sternheim trust are governed by the cited cases. The income tax controversy, of which these payments were a by-product, arose after decedent’s death. The action of the trustee of the Blanche Sternheim trust in withholding income had no relation to the circumstances existing at the date of death and certainly was hardly within the realm of reasonable anticipation at that time. In other words, these payments were purely accidental.

Aside from the foregoing considerations the payments in the other two categories hereinbefore described have intrinsic factual features of their own which prevent their having any effect upon the value of the charitable gifts. Those payments which were made during the process of disentangling the assets of the Blanche Sternheim trust from those of the

testamentary estate were made pursuant to an agreement of reimbursement which was performed in full. Obviously this involved no encroachment upon corpus whatever. The contribution toward the income tax settlement was made by way of compromise and therefore had nothing to do with the power to invade corpus here under consideration.

It is therefore respectfully submitted that the Tax Court, after having found that the factual situation prevailing at the date of death precluded any reasonable possibility of invasion of corpus, erred in holding that subsequent payments of principal rendered the value of the charitable gifts uncertain in retrospect.

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### CONCLUSION.

The deduction claimed by petitioner for the full value of the charitable remainders of the Ben Sternheim trust should be allowed in full and the judgment of the Tax Court should be modified to the extent necessary to effect such allowance.

Dated, San Francisco,

March 3, 1944.

Respectfully submitted,

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